Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 92-258
38416

In the Matter of

Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	))))	CC Docket No. 92-135

NOTICE OF PROPOSED RULEMAKING

Adopted: June 18, 1992; Released: July 17, 1992

By the Commission:

COMMENTS DUE: August 28, 1992

REPLY COMMENTS DUE: September 28, 1992

Table of Contents

	paragraph
I. INTRODUCTION	1
II. BACKGROUND	5
A. Composition of the LEC Industry	5
B. The LEC Price Caps Order	8
III. DISCUSSION	9
A. Optional Incentive Regulation Plan	9
1. Summary	9
2. Discussion	10
a. Frequency of Tariff Filings	10
b. Earnings Band	11
c. Cost Basis for Incentive Plan Tariffs	13
d. New Service	16
e. Pricing Flexibility	17
f. Infrastructure and Service Quality Reporting	20
g. Eligibility and Optional Basis	22
B. Historical Cost Tariffs for Small Companies (Section 61.39)	27
1. Summary	27
2. Discussion	28
C. Baseline Rate of Return Regulation Based on Prospective Costs (Section 61.38 and Part 69)	38
1. Current Rules	38
2. Proposed Revisions	42
D. Incentive Regulation and Regulatory Reform within NECA	46
E. Mergers and Acquisitions Under the Incentive Plan	49
IV. COMMENTS; PROCEDURAL RULES	51
V. ORDERING CLAUSES	57

I. INTRODUCTION

1. This Notice of Proposed Rulemaking continues the examination of improved regulatory regimes for small and mid-size local exchange carriers (LECs) as announced in the LEC Price Caps Order.[1] This Notice proposes regulatory reform for interstate services offered by small and mid-sized LECs that remain subject to rate of return regulation in the wake of our adoption of a price cap system for the largest LECs.[2] The proposed rules are intended to complement the price cap system by providing incentives for smaller companies to become more efficient and by encouraging technological development. Because these smaller companies provide service primarily to rural areas, this proposal will help bring ratepayer benefits gained from incentive regulation to rural Americans as well as urban populations served by the largest carriers.

2. Price cap regulation applies to 12 carriers, representing approximately 93 percent of the LEC industry total revenues. The approximately 1300 remaining carriers remain under rate of return regulation. The size, diversity, and regulatory history of this group presents substantial challenges to designing incentive-based regulatory reforms. First, these carriers have not elected to be regulated under the price cap plan. They appear to be adverse to the heightened risks inherent in a price cap system that requires prices to track a price cap over which the carrier has no control. Second, the regulatory history of these carriers, with the vast majority of them participating in the National Exchange Carrier Association (NECA) pooled rates, means that the Commission has not had direct carrier-by-carrier oversight of costs. When we adopted price cap regulation, it was our ability to analyze large carrier costs and prices that enabled us to adopt a price cap system that creates benefits for both ratepayers and carriers. Finally, carriers that remain under rate of return represent a diverse group of companies, from extremely small rural cooperatives to large, multi-state holding companies. Therefore, a price caps approach for these companies does not seem appropriate at this time.

3. We tentatively conclude that the preferred approach for regulatory reform for this segment of the LEC industry is a continuum of increasingly incentive based approaches that permit companies to choose a plan which best fits their circumstances. At each point along this continuum, regulatory reforms would be introduced to correct the efficiency disincentives that traditional, cost-plus regulation introduces. Carriers will be able, based upon their own unique characteristics, to move along the continuum toward price cap regulation as they choose. While each step may increase business

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[1] Second Report and Order, 5 FCC Rcd 6786, 6827 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (Erratum by Com. Car. Bur.) (LEC Price Caps Order), modified on recon. 6 FCC Rcd 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd 7482 (1991), further modified on recon. 6 FCC Rcd 4524 (1991) (ONA Part 69 Order), petitions for recon. of ONA Part 69 Order pending, appeal docketed, D.C. PSC v. FCC, No. 91-1279 (D.C. Cir. June 14, 1991).

[2] In developing this proposal, we have worked closely with members and representatives of the LEC industry, NECA, and interexchange carriers.

risks, it also promises increased rewards in the form of the potential for higher earnings and reduced administrative burdens. Efficiencies gained can be captured for ratepayers in subsequent tariff reviews. At the same time, the greater earnings realized by efficiency gains benefit shareholders and enhance the company's investment potential. We are committed to maintaining revenue neutrality among the options established in this rulemaking so that the mere election of a regulatory system does not affect the company's revenues.

4. This Notice addresses regulatory reform in three parts. The first part proposes an optional incentive plan for rate of return carriers that is designed as an intermediate step on the road to price cap regulation. The small company rules permit LECs serving 50,000 lines or fewer to develop traffic sensitive rates based on historical costs. The second part proposes to expand these rules to use historical costs to compute common line rates. Under the third part, we propose to streamline the basic rate of return regulation that would apply to companies not electing any of the optional regulatory plans. The third part of our proposal, while representing a substantial improvement in the regulatory structure for the 1300 small and mid-sized carriers, is a first, and not a final step in long term regulatory reform for these companies. In our efforts to adapt our regulations to changing communications needs, we will continue to explore alternative ways to assure customers receive quality services at reasonable costs.

II. BACKGROUND

A. Composition of the LEC Industry

5. Price cap regulation took effect for the largest LECs on January 1, 1991. Twelve of the sixteen LECs with more than 500,000 access lines participate in price cap regulation. Although price cap regulation is mandatory for eight of these LECs, four elected to become subject to price caps. Although none of the smaller LECs has selected price caps regulation, a substantial majority of telephone customers are now served by price caps companies.[3]

6. With all of the largest LECs subject to price caps regulation, the remaining companies, subject to rate of return regulation, may be divided into "small" and "mid-size" carriers. In general, small companies are locally owned and operated LECs, organized as closed corporations, cooperatives or mutuals. These small carriers fall within NECA Subset 3 definition -- annual revenues of less than $40 million -- and serve fewer than 50,000 access lines. The "mid-size" companies generally have multiple telephone company subsidiaries. The larger mid-size companies' stock is publicly traded; and, for the most part, these companies operate in more than one state.

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[3] Companies under price caps regulation represent 92.4 percent of the total access lines. Approximately 94.7 percent of the access minutes are reported by price caps companies. Price caps companies generate 93.7 percent of the total LEC industry revenue requirement. (1990 NECA data filed with the Commission).

7. Of the LECs that remain subject to rate of return regulation, almost all participate in the common line (CL) pool administered by NECA. In a pooling environment, rates are based upon the total costs and total demand of all participating companies. Each company receives its actual costs, plus its share of the pool's earnings. The major reason companies participate in pools is that the mechanism inherently enables sharing of risks, by providing a high degree of assurance that the company will recover its costs. The majority of the LECs participate in the NECA traffic sensitive (TS) pool. The rates for these pools and other small and mid-size company tariffs under Section 61.38 of the rules are based on projections of the LECs' allowable costs and demand. Of the 1308 local exchange study areas[4] that are not subject to price cap regulation, 1197 participate in the NECA traffic sensitive pool; and 1253 are included in the NECA common line pool. Thirty-nine small companies maintain traffic sensitive tariffs under Section 61.39 rules, outside of the NECA pool. Approximately 2.2 percent of the total LEC study areas (761 study areas) are average schedule companies;[5] 243 of these companies are cooperatives.

B. The LEC Price Caps Order

8. The LEC Price Caps Order stated that the Commission would "initiate further proceedings dealing specifically with regulatory issues of concern to small and mid-size LECs."[6] That Order further stated the Commission's intent to consider whether a lower productivity factor for small and mid-size LECs is appropriate "to provide a focused basis for their participation in price cap regulation."[7] As stated above, no small carriers and only four mid-size carriers have elected price caps. This may be due to their smaller size and inability to gain economies of scale and scope that could spread the risks associated with price caps over a greater economic base. The Order also committed to examine other regulatory options that "recognize the unique circumstances" facing smaller LECs.[8] Finally, the Order committed to a

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4 "Study areas" are, generally, a LEC's service area in a given state. The study area boundaries are frozen as of November 15, 1984. MTS and WATS Market Structure, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72, 80-286, 86-297, Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 2 FCC Rcd 5349 (1987). (A Notice of Proposed Rulemaking to revise the definition of a study area is pending).

5 Participating LECs receive monies from the NECA pools based upon their costs pursuant to cost studies (cost companies) or pursuant to the average schedules (average schedule companies). Thus, average schedule companies do not perform cost studies for rate making. These companies receive their interstate revenues from the NECA pools based on formulae developed by NECA and subject to the approval of the Commission. See 47 C.F.R. § 69.606.

6 Second Report and Order, 5 FCC Rcd 6786, 6827 (1990).

7 Id.

8 Id.

continued examination of small company issues "to ensure that desirable regulatory reforms are applied to small telephone companies as far as possible and applied with sensitivity to their special circumstances."[9]

III. DISCUSSION

A. Optional Incentive Regulation Plan

1. Summary

9. The optional incentive plan proposed in this Notice would be available to any non-price cap LEC that also participates in no NECA pool. In comparison to current rate of return regulation methodologies, the optional incentive plan we propose incorporates longer tariff periods, greater reliance on historical costs, broader earnings bands and greater pricing flexibility. The plan includes both price cap concepts, such as earning zones and rate flexibility, and a lagged rate of return. Every two years, rates would be recalculated based upon costs and demand established during an historical period. During the two years, carriers operating pursuant to this plan would have the incentive to keep costs from increasing because cost increases lessen their earnings while cost decreases permit greater earnings. In recognition of the lower risk this plan entails, benefits to carriers would be less than with full price cap regulation. It is also anticipated that this plan will serve as a transitional step for companies who eventually elect to participate in full price caps regulation.

2. Discussion

a. Frequency of Tariff Filings

10. Among the goals of our regulatory reform are simplification and the reduction of unnecessary regulatory burdens. One of the more substantial regulatory burdens that many LECs bear is the requirement to make annual tariff filings pursuant to Section 69.3 of the Commission's Rules. Based on our experience with biennial filings for the smallest carriers under Section 61.39 and our review of company-specific tariffs filed by rate of return carriers, we tentatively conclude that requiring tariff filings every two years under the incentive plan will substantially reduce regulatory burdens, simplify the tariff process, and still permit the Commission to scrutinize rates to meet our statutory obligations under the Communications Act. We request comment on whether companies electing participation in the incentive plan should retain the option of filing revisions within the two-year period. While the efficiency benefits of regulatory lag are strongest if prices are held constant, smaller carriers may experience cost changes that would render rates unreasonable. One possible solution is to permit a company seeking mid-term changes to bear a heavy burden of proving that cost changes render their current rates unreasonable.

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[9] Id.

b. Earnings Band

11. An integral part of the price caps plan is the earnings band which permits companies that lower costs by realizing efficiencies to retain the resulting higher earnings as a reward for the efficiencies gained. Under price caps, this potential reward is balanced by the potential risk that, if efficiencies are not realized, the carrier would experience cost increases which would yield lower earnings. Another balancing risk for price cap carriers is created by the requirement that carriers remain under price cap regulation. We tentatively conclude that an approach similar to the price cap earnings band is appropriate for this optional incentive plan. However, because this incentive plan entails less risk than price caps, we tentatively conclude that it must provide less reward.

12. The earnings zone for price cap carriers was initially defined using the authorized rate of return as a basis. Under price caps, a 300 basis point earning zone was defined, which permitted a carrier to retain earnings of 200 basis points above the initial prescribed level, and a portion of the earnings above that amount through the sharing mechanism.[10] For price cap carriers, earnings must fall below 100 basis points for 12 months before a mid-course correction may be filed, which would retarget rates to earn 100 basis points below the baseline rate of return. Under price caps an adjustment in the authorized rate of return would not directly affect the earning zones. Such a change in the rate of return, however, would affect the earning zone for carriers participating in this optional incentive plan. Under the plan, carriers would continue to target their rates at each biennial filing to the prescribed rate of return. We tentatively conclude that an appropriate earning zone for the incentive plan would extend from 100 basis points below the authorized rate of return, to 100 basis points above the authorized rate of return. We seek comment on this tentative conclusion and recommendations for the appropriate level of earnings, expressed in basis points above and below the authorized rate of return, that carriers should be permitted to retain under the plan. We also seek comment on whether to subject earnings over this amount to sharing requirements, as we do in price caps.[11]

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[10] LEC Price Caps Order, at 6801-02. The sharing mechanism under price caps permits carriers with earnings in excess of the earning zone to "share" a portion of the over earnings by refunding a portion of the excess earnings in the form of rate reductions.

[11] Enforcement issues generally should be addressed in CC Docket No. 92-133, Amendment to Parts 65 and 69 of the Commission's Rules to reform the Interstate Rate of Return Represcription and Enforcement Processes. Comments on sharing here are solicited only for the optional incentive plan.

c. Cost Basis for Incentive Plan Tariffs

13. Companies participating in this incentive plan would base their first tariff filing on a cost of service study for the most recent 12 month period with related demand data for the same period. Subsequent filings would be based on similar cost and demand information for all elements for the period since the carrier's last filing.

14. Because this plan creates lower risks than the price cap plan, carriers would be permitted, at the time of their biennial filings, to argue for the inclusion of additional costs that are known and measurable if such costs would otherwise cause the carrier to fall short of earning the minimum level. If the carrier shows that these costs would result in a short fall, the carrier would be required to target its rates to recover revenues at the low end of the permissible earnings band, i.e., 100 basis points below the authorized rate of return. Showings of such known and measurable costs would be subject to a higher burden than purely historical cost showings. Under price cap regulation, costs triggered by action beyond the control of the carrier--exogenous costs -- result in adjustment to the cap. The intent of the exogenous cost treatment under price caps is to assure that the price cap formula does not lead to unreasonably high or low rates.[12] We tentatively conclude that consideration of exogenous cost changes, as defined under price caps, should be factored into the rates of LECs participating in the proposed incentive plan. Carriers would therefore be able to include exogenous adjustments as well as other known and measurable changes in justifying new rate levels. Comment is sought on this proposal. Commenters should specifically suggest what types of costs would be properly recognized as "known and measurable".

15. This cost showing standard for carriers electing to file tariffs under the incentive plan would remove a substantial amount of uncertainty, as well as challenges to the support showings, by relying more heavily on historical costs. The reliance on historical costs for two-year periods would also encourage companies to operate with greater efficiencies because efficiencies gained result in greater earnings for the tariff period. Under the plan, except as otherwise provided, at the time of the biennial filing, rates would be targeted to the authorized interstate rate of return for the initial filing and for each subsequent filing.

d. New Services

16. Most carriers eligible to participate in this incentive plan serve areas contiguous with large companies that operate in a price cap environment and that have introduced a number of new services in recent years. The offering of new services by price cap carriers places competitive pressure upon neighboring exchange carriers to provide the same or similar services. Although the incentives created by this plan are in part dependent upon reliance on historical costs, we should include provisions to address the

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12 LEC Price Caps Order, at 6807.

introduction of new services by incentive plan companies. The required cost support showing for new service offerings provided in Section 61.38 of our rules would be inconsistent with our objectives of simplification and reducing regulatory burdens. More consistent with these objectives would be to provide some streamlining of rules for the introduction of new services under the plan. However, some guidelines for offering new services are necessary to assure that such offerings do not defeat the incentive structure of the plan. We therefore propose to permit carriers subject to the incentive plan to introduce new services with a presumption of lawfulness if the anticipated earnings are de minimis and do not exceed the rate charged by the geographically closest price cap regulated LEC[13] offering the same or similar service. At the end of twelve months, the carrier must calculate rates for the new service based upon the historical costs for that service. New service offerings for carriers under the incentive plan that do not fit within these parameters, would require the standard Section 61.38 showing. We tentatively conclude that 2 percent or less of a non-price cap company's total annual operating revenue is de minimis for purposes of the introduction of new services and seek comment on this conclusion as well as other methods of treating new services.

e. Pricing Flexibility

17. In order to respond to competitive pressures from neighboring price cap LECs, many rate of return regulated LECs may require a degree of pricing flexibility. Some degree of pricing flexibility is consistent with an incentive plan so that companies can more easily respond to underlying service cost changes resulting from efficiency gains.

18. We propose to incorporate a pricing flexibility element into the incentive plan that would include a "basket" and "service category" system similar to that of price caps. We propose three baskets in the incentive plan: common line, switched traffic sensitive, and special access with categories of services within each basket. Within each two-year tariff period, aggregate rates for each basket must remain unchanged. However, carriers may adjust rates within each service category by no more than 10 percent up or down during the two-year tariff period. Filings of rate adjustments that are within the limits set herein would be permitted on 14 days' notice, with a presumption of lawfulness if accompanied by a showing of revenue neutrality; i.e., that, absent a change in demand, the rate changes would generate the same revenue in each basket. Comment is sought on this proposal and the parameters contained therein.

19. We tentatively conclude that this approach for pricing flexibility within this incentive plan is consistent with our objectives; however, we seek comment on whether there should also be a lower limit for pricing flexibility. Comments endorsing a lower limit should present their arguments with

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[13] In some instances the closest LEC will not always be clear, e.g., where there are more than one LEC with abutting service territories. Therefore, in those circumstances we propose to prohibit the price for the new service exceeding the highest price of any price cap LEC with an abutting service territory.

specificity. Comments opposing a lower limit should state why predatory pricing would not arise.

f. Infrastructure and Service Quality Reporting

20. One of the primary objectives of this plan is to encourage carriers to operate with greater efficiency. Incentive regulation has, however, raised concerns that a company may simply pursue the most cost effective means to accomplish a task to the detriment of service quality and ultimately to the company's infrastructure. Such a course of action would yield higher earnings for the company but would cause harm to its ratepayers.

21. Monitoring the service quality and infrastructure development of companies that elect participation in this incentive program would allow us to evaluate any service quality deterioration under an incentive plan. Therefore, we tentatively conclude that all carriers that elect to become subject to this incentive plan would be required to file the quarterly service quality information reports required of all price caps carriers. We also propose that these carriers file the information contained in the annual infrastructure reports filed by the LECs for which price caps are mandatory;[14] however, we propose that the incentive plan carriers would file such reports every two years, concurrent with their biannual tariff filings. We seek comment on the need for further measures to assure that service quality and infrastructure development are not adversely affected by our adoption of an incentive plan.

g. Eligibility and Optional Basis

22. This incentive plan would be available to any non-price cap LEC that also participates in no NECA pool. Our tentative decision to limit eligibility to depooled carriers is based on the same concerns we articulated in determining price cap eligibility for LECs. Pools are created to spread risks and earnings. The regulatory approach of this optional incentive plan appears inconsistent with pooling because in a pool, neither the balance of risk and benefit, nor the incentives for efficiency can be targeted to specific pool members. Thus we tentatively conclude that the incentive plan should not be available to companies that collectively offer a single interstate tariff with pooled rates or earnings.

23. Companies subject to rate of return regulation are diverse, ranging from very small to large companies. These companies also vary in terms of cost characteristics and demand growth or decline in their serving areas. Because of the varied circumstances of each company, the risks and rewards of incentive regulation plans for each will differ in ways that are difficult to predict. We tentatively conclude that any incentive plan designed for rate of return carriers should be optional.

24. To maximize the benefits of an incentive plan, the company's total regulated interstate operations should be subject to the plan. However, because many smaller companies lack the economies of scale of larger carriers,

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14 LEC Price Caps Order, at 6827-6835.

these companies may experience sufficient instability in their common line revenues to dissuade them from participating in the plan if such an all-or-nothing approach is employed. We nonetheless tentatively conclude that companies electing the incentive plan develop and maintain both common line and traffic sensitive rates within the incentive plan rules. Comment is also sought on this proposal; parties urging adoption of a bifurcated approach (e.g., allowing participation for TS only) should provide data and information supporting their views.

25. Because under the incentive plan rates would be based on actual historical costs, it may be necessary to permit average schedule study areas of companies electing the incentive plan to remain in the NECA pools. Should such carriers wish to include their average schedule study areas in the incentive plan, we propose that the performance of cost studies be required. We seek comments on this proposal.

26. Under our price cap rules, an election to participate in price caps is irrevocable. While commitment to the plan for a period of time is necessary for incentive regulation to be effective, we do not conclude that this incentive plan, subject to biannual rate of return-based recalculation, must be irrevocable. Nevertheless, we believe that a degree of commitment by incentive plan companies should be required to assure that the incentives can work. We therefore propose that carriers electing participation in the incentive plan, must remain in the plan for no less than 2-years. If a carrier subsequently elects not to participate in the plan, it must file rates pursuant to Section 61.38 on a company-specific basis. The company would not be eligible to return to the incentive plan until the fourth year after the year in which it ceased its participation in incentive regulation.

B. Historical Cost Tariffs for Small Companies (Section 61.39)

1. Summary

27. Section 61.39 permits small telephone companies to file tariffs for their traffic sensitive rates every two years in lieu of participating in the NECA traffic sensitive pool. The rates are developed from the company's actual historical costs, or historical average schedule settlements. Thus, Section 61.39 incorporates reliance on historical costs and longer tariff periods. Eligibility is limited to LECs serving 50,000 or fewer access lines, realizing total annual revenues of $40 million or less. In 1991, 39 small companies filed on a non-pooled basis traffic sensitive rates under Section 61.39. This section of this Notice proposes to expand these rules to provide for similar regulatory treatment of common line rates.

2. Discussion

28. On April 11, 1989, the Unites States Telephone Association (USTA) filed a petition for rulemaking seeking reduced regulatory burdens for depooled small local exchange carriers by allowing them to extend their historical-cost based filing approach to their carrier common line (CCL) charge and subscriber line charge (SLC) tariff filings. Specifically, the petition requested the Commission to conduct a rulemaking to allow small companies, both cost and

average schedule, the option to leave the NECA CCL pool and be subject instead to the following provisions: (1) CCL and SLC tariff filings would be based on the most recent historical costs and demand, or the most recent average schedule settlement formula; (2) CCL and SLC rates would be considered presumptively reasonable; (3) common line tariffs would be filed every other year; (4) carriers would be exempt from the supporting information requirements of Section 61.38; (5) Part 65 refund requirements would not be applicable; (6) the carriers would reference NECA's Tariff F.C.C. No. 5, regarding terms and conditions, but use their own costs or average schedule settlements for rate derivation; (7) small and large carriers would be required to comply with the Commission's rules regarding long-term and transitional support as if there were no withdrawals from the pool; and (8) average schedule carriers would calculate their CCL rates based on the revenue requirements of NECA's most recent average schedule formula, subtracting their own anticipated SLC revenues as set by the Commission for carriers participating in the NECA SLC tariff. The petition does not define "small carriers" but appears to assume that the Section 61.39 eligibility criteria would apply. Under the current rules, the carriers would only have to submit cost data if the Commission specifically requests it. The only two parties commenting on USTA's petition were NECA and the Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO). These parties strongly supported the USTA petition.

29. We have compared the rates generated under Section 61.39 for traffic sensitive tariffs to the rates filed by NECA and other carriers under Section 61.38. Generally, rates filed by Section 61.39 carriers have been consistently lower than the NECA rates. Increases were less than NECA increases; reductions were greater than NECA rate reductions. Based on these findings, we tentatively conclude that the traffic sensitive rates filed under Section 61.39 have reasonably reflected the intent and policies underlying this rule. In particular, the Commission's goal of rate neutrality has been met.[15] Since the implementation of the small company rules, approximately forty LECs have used the provisions. We tentatively conclude that the small company rules have neither encouraged nor discouraged participation in NECA pools. Therefore, the Commission's goal of pooling neutrality has also been met. The petitioners believe that these rules have effectively reduced regulatory burdens, allowing smaller LECs to maintain company specific traffic sensitive rates. The experience of companies under Section 61.39 for traffic sensitive rates has been positive, and supports a decision to consider expansion of those rules to include common line rates.

30. As suggested above, the chief policy consideration cited in the Small Company Rulemaking in favor of the modified filing requirements for traffic sensitive rates was the reduction of administrative burdens on small LECs, who

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[15] In the Small Company Order, the Commission defined "rate neutrality" as ensuring that "their access rates are not unreasonably high." 2 FCC Rcd 1012 (1986).

generally have limited resources to meet more detailed filing requirements.[16] This same general concern would apply to common line rate filings as well. Even though the NECA pools themselves impose low administrative burdens upon members and substantial benefits to the Commission, options of using historical costs, with a presumption of reasonableness, and of applying the same ratemaking methodologies for traffic sensitive and common line, respectively, could bring smaller LECs significant relief.

31. Such relief for the carriers may require the Commission to conduct additional monitoring to ensure the accuracy and reasonableness of historical costs. The Commission under existing small company rules presumed that interexchange carriers would monitor the small companies' rates, and therefore directed small companies to provide the necessary information to the interexchange carriers. The interexchange carriers, however, would have no direct interest in monitoring the reasonableness of SLC rates, and these rates are of special concern to the Commission.

32. Even if the administrative burden were equal for traffic sensitive and common line filings, the underlying cost structures of traffic sensitive and common line rates are so different that genuine rate neutrality may be impossible without some modification of USTA's proposal. Under rate of return principles, rate neutrality ought to include consideration of costs and net revenue, in addition to rate levels per se. For traffic sensitive elements, recent historical costs are closer to actual, near-term, future costs because there is an inherent continuity of cost levels over short time spans. For example, a change in demand is likely to cause a similar change in costs allocated by the separations process.[17]

33. For common line rates, however, the total costs are derived from a fixed 25 percent allocation of total common line costs to the interstate jurisdiction in separations and are recovered by CCL rates, SLC rates and the special access surcharge. CCL rates cover the remaining costs after SLC and special access surcharge revenues are subtracted. Calculation of proper rates for each of these elements, taking into account support payments, is likely to be more complicated than for traffic sensitive rates, even when historical cost and demand are used. In addition, the growth in demand for common line minutes relative to essentially fixed common line costs may create an intrinsic distortion which would continuously drive future unit costs below historical unit costs. This would give a windfall to the carrier, even in the absence of actual economies. On the other hand, this situation may arise only if demand

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[16] Regulation of Small Telephone Companies, CC Docket No. 86-467, Notice of Proposed Rulemaking, 2 FCC Rcd 1010(1986); Report and Order, 2 FCC Rcd 3811 (1987), on recon., 3 FCC Rcd 5770 (1988) (Small Company Rulemaking).

[17] To the extent the carrier can actually reduce traffic sensitive costs from one biennial filing to the next, any lag would enable it to enjoy a limited, temporary increase in net revenue. In fact, this functions as a simplified incentive regulation plan, with a short term reward for increased productivity and efficiency, but without prospective adjustments for inflation, productivity, and exogenous costs, as required under price caps.

growth is very strong, because SLC rates are capped and cost increases flow to the residual CCL rates. It is not clear whether growth would be equally strong in the future. It seems likely that applying the traffic sensitive approach to CCL and SLC may be too generous to some LECs and too harsh on others. Therefore, a methodology is needed that assures fairness to subscribers paying SLC rates and that factors individual company demand growth into the calculation of CCL rates.

34. We tentatively conclude that these concerns regarding the derivation of SLC and CCL rates under an expanded Section 61.39 can be adequately addressed. Companies electing to file common line rates under Section 61.39 would perform the calculations specified in Part 69 of the Commission's Rules using costs from the most recent 12-month period (or most recent common line settlements through the average schedules). To derive demand, the company would determine the average CCL usage and the percentage growth in usage over the most recent 24-month period. This method ensures revenue neutrality by factoring the company's historical demand growth into the rates. Demand for the rate period would be determined by a simple extrapolation of base period demand increased by base period percent growth. Companies filing common line rate under Section 61.39 would file their SLC calculations with the Commission at the time the tariffs are filed.[18] Common line demand growth in the historical period would be applied to the historical costs for that period. Thus, the carrier has the incentive to increase demand during the tariff period. If demand is increased, the stockholders benefit from higher earnings. Ratepayers benefit through lower rates established for the next tariff period which would be based on lower rates resulting from the increased demand.

35. We tentatively conclude that the goals of simplification, reduction of regulatory burdens, and assurance of reasonable rates, can be achieved by permitting eligible carriers to elect Section 61.39 rules for either traffic sensitive or both traffic sensitive and common line rate development. If a carrier elects Section 61.39 for only traffic sensitive rates the carrier would remain in the NECA common line pool.

36. Other aspects of the current Section 61.39 rules would apply to this proposed common line expansion. The tariffs would continue to be filed every other year. Mid-course corrections would be permitted and evaluated on a case-by-case basis. To assist carriers electing this option, NECA would be required to file a simplified access tariff containing terms and conditions, and permit small companies that choose to file separate access rate schedules to reference the NECA tariff for terms and conditions.

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[18] We would propose that the support for calculations of CCL rates be treated the same as traffic sensitive rate cost support -- the supporting information would not need to be filed. However, the company should retain the information in case the Commission subsequently needs it. In addition, the cost support would be made available to interexchange carrier customers upon reasonable request.

37. Finally, in the Small Company Rulemaking[19] small companies filing under Section 61.39 were excluded from the automatic refund requirement. The Commission emphasized that these carriers remain subject to the rate of return prescription in effect at the time rates are in effect, and that if the actual return exceeded the authorized return, the Commission reserved the right, at its discretion, to enforce its rate of return prescription by appropriate action. This issue is being addressed in CC Docket No. 92-133. Interested parties should comment on this aspect of the small company rules in that proceeding.

C. Baseline Rate of Return Regulation Based on Prospective Costs (Section 61.38 and Part 69)

1. Current Rules

38. Current rules generally require carriers subject to rate of return regulation, including NECA, to file tariffs with the Commission every year.[20] Small companies, serving 50,000 access lines or fewer, that qualify as NECA subset 3 carriers (annual operating revenues of $40 million or less), may opt to file traffic sensitive rates every other year.[21]

39. Supporting information required with annual tariff filings includes: a cost of service study for the previous year; a study of projected costs for the tariff period; and estimates of the effect of proposed tariff changes on traffic and revenues.[22] The specific data formats for the supporting information are detailed in a Tariff Review Plan (TRP), which is released by the Common Carrier Bureau each year.[23] The level of cost, demand, and revenue data required by the TRP varies, with greater detail demanded of the larger carriers. The TRP divides companies into three groups -- Tier 1, Tier 2A, and Tier 2B -- for purposes of establishing different levels of support data.[24]

40. This NPRM refers to these requirements as the "baseline" requirements for rate of return carriers. This baseline of regulation is applicable to NECA and individual companies or groups of companies that choose not to participate in the NECA pools and choose not to elect either the small company rules (§ 61.39) for traffic sensitive rates or price caps regulation.

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19 Small Company Rulemaking at 3813.

20 47 C.F.R. §69.3

21 47 C.F.R. § 69.3(f).

22 47 C.F.R. § 61.38(b).

23 See, e.g., Commission Requirements for Cost Support Material To Be Filed with 1992 Annual Access Tariffs, 7 FCC Rcd 1477 (1992) (TRP Order).

24 Id. at paras. 5-7.

41. The rules and level of detail required in annual tariff filings are substantially the same as those that were applied to the entire LEC industry prior to the implementation of price caps. This level of detail was deemed necessary for the Commission to review adequately tariff proposals of the largest carriers, in an environment where all LECs were subject to the same form of regulation and all participated in the common line pool administered by NECA. As already noted, approximately 93 percent of the LEC industry is now subject to price caps regulation, and all pooling is optional.

2. Proposed Revisions

42. As stated above, current baseline requirements apply to NECA and individual companies that do not elect price caps or Section 61.39 for traffic sensitive rates. As proposed, the modified baseline requirements would apply to rate of return carriers that do not elect the optional incentive plan and to rates of small companies not governed by Section 61.39. We tentatively conclude that the level of detail required to support tariff filings under our current rate of return regulation is excessive. The Commission's statutory obligations may be met and administrative burdens reduced by reforming the existing baseline requirements. We seek comment on this conclusion, and on specific modifications to rate of return regulation proposed below.

43. We believe that the frequency of required tariff filings for the baseline may be a facet of our baseline requirements ripe for regulatory reform. It may be adequate to require baseline tariff filings every other year. This would not limit carriers from filing more frequently. Our experience with tariff filings under Section 61.39 shows that reducing the number of required tariff filings can lower administrative costs, and still ensure that carriers establish reasonable service rates.

44. The methodologies used to project costs and demand may also be simplified and still provide sufficient information to set just and reasonable rates. Specifically, projected costs and demand data may be developed as simple extrapolations of historical costs and demand. Alternatively, it may be possible to require only historical costs to support certain rate elements, such as traffic sensitive rates. Under this approach, carrier common line rates would be based upon cost and demand growth in the historical period and exogenous changes as defined in the price caps rules.

45. We seek comment on whether more streamlined procedures for the introduction of new services for carriers using baseline rate of return regulation would serve the public interest. Many small companies serve areas adjacent to those of Bell Operating Companies or other large carriers. When a larger carrier offers a new service, competitive necessity may require the smaller carrier to offer the service too. New services and technologies are as important to small towns and rural areas as they are to cities. Thus, we propose to apply streamlined procedures, -- 14-days' notice periods and a presumption of lawfulness -- to new service offerings of rate of return regulated carriers when the service's anticipated revenues are less than 2 percent of the company's total annual operating revenue. A second requirement for streamlined treatment would be that the rate levels for such services be no

higher than those of a neighboring LEC offering of the same service.[25] We also seek any other proposals concerning regulatory treatment of new services that are consistent with the goals stated in this Notice.

D. Incentive Regulation and Regulatory Reform within NECA

46. NECA performs a necessary role in the fulfillment of the mandates of the Communications Act. NECA administers programs that support the goals of universal service, provides carriers a means of risk sharing, and performs administrative functions for its members that lessen their regulatory and administrative burdens. For these reasons, alternative regulatory approaches should remain optional for NECA pooling participants. While NECA and the majority of its participants endorse this view, some of these carriers, particularly those experiencing competitive pressures to reduce rates, express interest in incentives for increased efficiency for pooled services.

47. Implementing incentive regulation for NECA participants presents a series of difficult issues however. The LEC Price Caps Order concluded that "participation in pools, by its nature, entails risk-sharing, and thus a weakening of incentives to operate efficiently."[26] For this reason NECA participants and, in effect NECA itself, were excluded from price caps regulation.[27] These findings assume that efficiency incentives and pooling are incompatible. We now seek to determine whether this is correct, or whether there are means of introducing incentive regulation into the pooling environment. A possible means would be to permit a NECA participant to commit to its historical settlement amount, for a period of years. For example, an individual company would be permitted to contract with the pool to accept as its full annual settlement an amount represented by an average of its annual pool settlements over the preceding three years. Comment on this and other means of providing incentive options within the NECA pools is sought. Additionally, NECA is encouraged to develop alternative incentives to encourage more efficiency in the pooling environment.

48. The Commission recognizes the difficulties involved in developing incentive options for pooled services. Because competitive pressures to establish such mechanisms will likely increase with time, we do not wish to preclude their development once this proceeding is concluded. In addition, current rules may present obstacles to the implementation of such options. Therefore suggestions are sought for rule revisions that will enable the implementation of incentive options within the pool at some future time.

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[25] See note 13, supra.

[26] LEC Price Caps Order, at para 266.

[27] Id.; the Order, however, did permit NECA participants to exit the pools, become subject to Section 61.38 cost supported, company-specific tariffs, and elect price caps in a subsequent year.

E. Mergers and Acquisitions Under the Incentive Plan

49. In CC Docket 89-2, the Commission adopted a rule permitting LECs involved in mergers and acquisitions to retain their pre-transaction pooling status.[28] The rule's objective was to keep pooling rules neutral with regard to mergers and acquisitions. However, in the LEC Price Caps Order, the Commission found that a price cap carrier that acquires a non-price cap carrier (other than an average schedule company) would be required to convert that carrier to price cap regulation within one year after the effective date of the transaction.[29] The Commission reasoned that the incentives and limitations facing a company that has both price cap and non-price cap affiliates would be very different from those facing a company that has both pooled and non-pooled affiliates.[30]

50. The issue now is whether an incentive plan carrier that subsequently acquires a non-incentive plan carrier should be required to convert the latter to the incentive plan. With one exception, the rationale of the LEC Price Caps Order, which would require conversion because of the negative incentives and limitations resulting from not imposing such a requirement, appears even more persuasive in this case than it was even under the price cap model. The exception would arise when a small, baseline regulated carrier acquires a few exchanges of a mid-size incentive regulated carrier. The acquiring carrier or the company resulting from the merger would be required to petition the Commission to merge affected study areas. Comment is sought on how the proposed rules will affect companies involved in mergers and acquisitions.

IV. COMMENTS; PROCEDURAL RULES

51. This notice of proposed rulemaking is being issued pursuant to the LEC Price Caps Order and to determine whether proposals presented here to modify the regulations governing LECs subject to rate of return regulation would be in the public interest. In this notice and comment rulemaking we expect to develop all the relevant, material and probative data and information needed to make that public interest determination. We also seek comment on any other proposals which could produce incentives for non-price cap LECs to be more efficient.

52. For purposes of this non-restricted informal rulemaking proceeding, members of the public are advised that ex parte contacts are permitted from the time of issuance of a notice of proposed rulemaking until the time a draft Order proposing a substantive disposition of the proceeding is placed on the Commission's Open Meeting Agenda. In general, an ex parte presentation is any written or oral communication (other than formal written comments or pleadings

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[28] Amendment of Part 69 of the Commission's Rules Relating to the Common Line Pool Status of Local Exchange Carriers involved in Mergers or Acquisitions, CC Docket No. 89-2, 5 FCC Rcd 231 (1989).

[29] LEC Price Caps Order, at para. 282.

[30] Id., at para. 284.

and oral arguments) between a person outside this Commission and a Commissioner or a member of this Commission's staff which addresses the merits of the proceeding. Any person who submits a written ex parte presentation must serve a copy of that presentation on this Commission's Secretary for inclusion in the public file. Any person who makes an oral ex parte presentation addressing matters not fully covered in any written comments previously filed in the proceeding must prepare a written summary of that presentation. On the day of the oral presentation, that written summary must be served on this Commission's Secretary for inclusion in the public file, with a copy to the Commission official receiving the oral presentation. Each ex parte presentation discussed above must state on its face that the Secretary has been served, and must also state by docket number the proceeding to which it relates. See generally Section 1.1231 of the Commission's Rules. 47 C.F.R. § 1.1231.

53. Pursuant to applicable procedures set forth in Section. 1.415 and 1.419 of the Commissions Rules, 47 C.F.R. §§ 1.415 and 1.419, interested parties may file comments in this proceeding on or before August 28, 1992 and reply comments on or before September 28, 1992. All relevant and timely comments will be considered by this Commission before final action is taken in this proceeding. In reaching its decision, the Commission may take into consideration information and ideas not contained in the comments, provided that such information or a writing indicating the nature and source of such information is placed in the public file, and provided that the fact of the Commission's reliance on such information is noted in the Report and Order.

54. To file formally in this proceeding, participants must file and original and five copies of all comments, reply comments and supporting comments. If participants want each Commissioner to receive a personal copy of their comments an original and 11 copies must be filed. Comments and reply comments should be sent to the Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the Commission's Public Reference Room (Room 239) at is headquarters at 1919 M St., N.W., Washington, D.C.

55. The proposal contained herein has been analyzed with respect to the Paperwork Reduction Act of 1980 and found to impose a new or modified information collection requirement on the public. Implementation of any new or modified requirement will be subject to approval by the Office of Management and Budget as prescribed by the Act.

56. We have determined that Section 605(b) of the Regulatory Flexibility Act of 1980, 5 U.S.C. § 605(b) does not apply to this rulemaking proceeding because if promulgated, it would not have a significant economic impact on a substantial number of small entities. The definition of a "small entity" in Section 3 of the Small Business Act excludes any business that is dominant in its field of operation. Although some of the local exchange carriers that will be affected are very small, local exchange companies do not qualify as small entities because they have a nationwide monopoly on ubiquitous access to the subscribers in their service area. The Commission has found all exchange carriers to be dominant in the Competitive Carrier proceeding. 85 FCC 2d 1,

23-24 (1980). To the extent that small telephone companies will be affected by these rules, we hereby certify that these rules will not have a significant economic effect on a substantial number of "small entities." Although we do not find that the Regulatory Flexibility Act is applicable to this proceeding, this Commission has an ongoing concern with the effect of its rules and regulation on small business and the customers of the regulated carriers as is evidenced by this proceeding. The Secretary shall send a copy of this Notice of Proposed Rulemaking, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration in accordance with paragraph 603(a) of the Regulatory Flexibility Act. Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. Section 601 et seq (1981).

V. ORDERING CLAUSES

57. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 4(j), 201-205, 303(r), and 403 of the Communications Act of 1934, 47 U.S.C. §§ 154(i), 154(j), 201-205, 303(r), 403, NOTICE IS HEREBY GIVEN of proposed amendments to Part 61, and Part 69, and Sections 61.38, 61.39, 61.50, 61.58, and 69.3, in accordance with the proposals, discussions, and statement of issues in this Notice of Proposed Rulemaking, and as set forth in Appendix A to this Order, and that COMMENT IS SOUGHT regarding such proposals, discussion, and statement of issues.

58. Accordingly, IT IS ORDERED, that a rulemaking proceeding IS INSTITUTED to determine whether proposals made herein concerning regulatory reform for LECs which remain subject to rate of return regulation would be in the public interest.

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy

Donna R. Searcy
Secretary

APPENDIX A

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

Title 47 of the CFR, Parts 61, 65, and 69 are amended as follows:

PART 61 — TARIFFS

59. The authority citation for Part 61 continues to read as follows:

AUTHORITY: Sec. 4, 48 Stat. 1066, as amended; 47 U.S.C. 154. Interpret or apply sec. 203, 48 Stat. 1070; 47 U.S.C. 203.

60. Section 61.3 is amended by revising paragraph (e) to read as follows:

§ 61.3 Definitions.

* * * * *

(e) Base period. The 12-month period ending six months prior to the effective date of annual price cap tariffs, or the 24-month period ending six months prior to the effective date of biennial optional incentive plan tariffs.

* * * * *

61. Section 61.38 is amended by revising paragraph (a) to read as follows

§ 61.38 Supporting Information to be submitted with letters of transmittal.

(a) Scope. This Section applies to dominant carriers whose gross annual revenue exceed $500,000 for the most recent 12 month period of operations or are estimated to exceed $500,000 for a representative 12 month period. Local exchange carriers serving 50,000 or fewer access lines in a given study area that are described as subset 3 carriers in § 69.602 of this chapter may submit Access Tariff filings for that study area pursuant to either this section or § 61.39. However, the Commission may require any carrier to submit such information as may be necessary for a review of a tariff filing. This section (other than the preceding sentence of this paragraph) shall not apply to tariff filings proposing rates for services identified in §§ 61.42 (a), (b), (d), (e), and (g), promotional offerings that relate to services subject to price cap regulation, tariff filings proposing rates for services identified in §61.50, or to tariff filings, other than promotional filings, filed on 14 days notice pursuant to § 61.58(c)(6).

* * * * *

62. Section 61.39 is amended by revising paragraphs (a) and (b) to read as follows:

§ 61.39 Optional supporting information to be submitted with letters of transmittal for Access Tariff filings effective on or after April 1, 1989, by

local exchange carriers serving 50,000 or fewer access lines in a given study area that are described as subset 3 carriers in Sec. 69.602.

(a) Scope. This Section provides for an optional method of filing for any local exchange carrier that is described as subset 3 carrier in § 69.602, which elects to issue its own Access Tariff for a period commencing on or after April 1, 1989, and which serves 50,000 or fewer access lines in a study area as determined under § 36.611(a)(8) of the Commission's Rules. However, the Commission may require any carrier to submit such information as may be necessary for review of a tariff filing. This section (other than the preceding sentence of this paragraph) shall not apply to tariff filings proposing rates for services identified in § 61.42(d), (e), and (g), which filings are submitted by carriers subject to price cap regulation, or to tariff filings proposing rates for services identified in § 61.50, which filings are submitted by carriers subject to optional incentive regulation.

(b) Explanation and data supporting tariff changes. The material to be submitted for either a tariff change of a new tariff which affects rates or charges must include an explanation of the filing in the transmittal as required by § 61.33. The basis for ratemaking must comply with the following requirements. Except as provided in paragraph (b)(5) of this section, it is not necessary to submit this supporting data at the time of filing. However, the local exchange carrier should be prepared to submit the data promptly upon reasonable request by the Commission or interested parties.

(1) For a tariff change, the local exchange carrier which is a cost schedule carrier must propose Traffic Sensitive rates based on the following:

(i) For the first period, a cost of service study for Traffic Sensitive elements for the most recent 12 month period with related demand for the same period.

(ii) For subsequent filings, a cost of service study for Traffic Sensitive elements for the total period since the local exchange carrier's last annual filing, with related demand for the same period.

(2) For a tariff change, the local exchange company which is an average schedule carrier must propose Traffic Sensitive rates based on the following:

(i) For the first period, the local exchange carrier's most recent annual Traffic Sensitive settlement from the National Exchange Carrier Association pool.

(ii) For subsequent filings, an amount calculated to reflect the Traffic Sensitive average schedule pool settlement the carrier would have received if the carrier had continued to participate, based upon the most recent average schedule formulas developed by the National Exchange Carrier Association.

(3) For a tariff change, the local exchange carrier which is a cost schedule carrier must propose Common Line rates based on the following:

(i) For the first period, a cost of service study with demand for all Common Line elements for the most recent 12 month period with demand adjusted to reflect the growth in demand for the same period.

(ii) For subsequent filings, a cost of service study with demand for all Common Line elements for the total period since the local exchange carrier's last annual filing with demand adjusted to reflect the growth in demand for the same period.

(4) For a tariff change, the local exchange carrier which is an average schedule carrier must propose rates based on the following:

(i) For the first period, the local exchange carriers most recent annual Common Line settlement from the National Exchange Carrier Association and actual demand for the most recent 12 month period with demand adjusted to reflect the growth in demand for the same period.

(ii) For subsequent filings, an amount calculated to reflect the average schedule pools settlement the carrier would have received if the carrier had continued to participate, based upon the most recent average schedule Common Line formulas developed by the National Exchange Carrier Association and actual demand for the same period with demand adjusted to reflect the growth in demand for the same period.

(5) For End User Common Line charges included in a tariff pursuant to this Section, the local exchange carrier must provide supporting information for the two-year historical period with its letter of transmittal in accordance with § 61.38.

* * * * *

63. Section 61.50 is added to read as follows:

§ 61.50 Optional incentive regulation for rate of return local exchange carriers.

(a) This section shall apply on an elective basis, to local exchange carriers that are neither participants in any Association tariff, nor affiliated with any such participants, except that affiliation with average schedule companies shall not bar a carrier from electing optional incentive regulation provided the carrier is otherwise eligible.

(b) If a telephone company, or any one of a group of affiliated telephone companies, files an optional incentive regulation tariff in one study area, that telephone company and its affiliates, except its average schedule affiliates, must file incentive plan tariffs in all their study areas.

(c) The following rules apply to telephone companies subject to this section, which are involved in mergers, acquisitions, or similar transactions, except that mergers with, acquisitions by, or other similar transactions with companies subject to price cap regulation, as that term is defined in § 61.3(W), shall be governed by § 61.41(c).

(1) Any telephone company subject to this section that is a party to a merger, acquisition, or similar transaction, shall continue to be subject to incentive regulation notwithstanding such transaction.

(2) Where a telephone company subject to this section acquires, is acquired by, merged with, or otherwise becomes affiliated with a telephone company that is not subject to this section, the latter telephone company shall become subject to optional incentive plan regulation no later than one year following the effective date of such merger, acquisition, or similar transaction and shall accordingly file optional incentive plan tariffs to be effective no later than that date in accordance with the applicable provisions of this Part 61.

(3) Notwithstanding the provisions of paragraph (c) (2) of this section, when a telephone company subject to optional incentive plan regulation acquires, is acquired by, mergers with, or otherwise becomes affiliated with a telephone company that qualifies as an "average schedule" company, the latter company may retain its "average schedule" status or become subject to optional incentive plan regulations in accordance with § 69.3(i)(3) of this chapter and the requirements references in that section.

(d) Local exchange carriers that are subject to this section shall not be eligible to withdraw from such regulation until the end of a two-year tariff period. If a local exchange carrier withdraws from optional incentive plan regulation, it must file company-specific tariffs under the provisions of § 61.38 for four years before becoming eligible to enter incentive plan regulation; such carrier may not participate in any Association tariff during that four years.

(e) Each local exchange carrier subject to this section shall establish baskets of services as identified in § 61.42 (d), (e) and (f).

(f) Each local exchange carrier subject to optional incentive regulation shall exclude from its baskets such services or portions of such services as the Commission has designated or may hereafter designate by order.

(g) New services, other than those within the scope of paragraph (f) of this section, must be included in the affected basket 12 months after their introduction. To the extent that such new services are permitted or required to be included in new or existing service categories within the assigned basket, they shall be so included 12 months after their introduction.

(h)(1) Except as provided in paragraph (c)(4) of this section, in connection with any optional incentive plan tariff filings proposing rate changes, the carrier must calculate an API for each affected basket as proscribed in § 61.46 (a), (b) and (c).

(2) In connection with any tariff filed under this section proposing changes to rates for services in the basket designated in paragraph (e)(1) of this section, the maximum allowable carrier common line (CCL) charges shall be limited to a ten percent increase over the two-year tariff period, where the

sum of each of the proposed Carrier Common Line rates multiplied by its corresponding historical period Carrier Common Line minutes of use is divided by the sum of all types of base period Carrier Common Line minutes of user.

(i) New services introduced pursuant to this section are deemed presumptively lawful, if the projected revenues for the new service are less than two percent of the carrier's total access revenues during the first 12 months of the offering, and the proposed rates, in the aggregate, are no greater than the rate for the same or comparable service offered by a price cap regulated local exchange carrier providing service in an adjacent serving area. Tariff filings made pursuant to this paragraph must include the following:

(1) A study containing a projection of costs for a representative 12 month period;

(2) Data to establish that the annualized projected service revenues during the first 12 month period of the service offering will be less than two percent of the carrier's total interstate access revenues during the most recent 12 month period; and

(3) Data to establish that, in aggregate, the proposed rates for the new service are no greater than those in effect for the same or comparable service offered by a geographically adjacent price cap regulated local exchange carrier.

64. Section 61.58 is amended by adding new paragraph (e) to read as follows:

§ 61.58 Notice requirements.

* * * * *

(e) Carriers subject to optional incentive regulation. This paragraph applies only to carriers subject to Section 61.50 of this Part. Such carriers must file tariffs according to the following notice periods:

(1) For initial and renewal tariff filings whose effective date coincides with the start of any two-year tariff period as defined in § 69.3(f) of this chapter, filings must be made on not less than 90 days' notice.

(2) For rate revisions made pursuant to § 61.50(j) and (k), tariff filings must be made on not less than 14 days' notice.

PART 69 — ACCESS CHARGES

1. The Authority citation for Part 69 continues to read as follows:

AUTHORITY: Secs. 4, 201, 203, 205, 218, 403, 48 Stat, 1066, 1070, 1072, 1077, 1094, as amended 47 U.S.C. §§ 154, 201, 202, 203, 205, 218, 403, unless otherwise noted.

2. Section 69.3 is amended by revising the first sentence of paragraph (a), revising the first sentence of paragraph (e), and paragraph (i) introductory text, paragraph (i)(1), and paragraph (i)(3) to read as follows:

§ 69.3 Filing of access service tariffs.

(a) Except as provided in paragraph (h) of this section, a tariff for access service shall be filed with this Commission for a two-year period. ***

* * * * *

(e) A telephone company or group of telephone companies may file a tariff that is not an association tariff, except that a group rate for non-affiliated telephone companies may not be file tariff under Section 61.50; e.g., the Association. ***

* * * * *

(i) The following rules apply to the withdrawal from Association tariffs under the provision of paragraphs (e)(6) or (e)(9) of this section or both by telephone companies electing to file price cap tariffs pursuant to § 69.3(h) or optional incentive plan tariffs pursuant to § 61.50 of this chapter.

(1) In addition to the withdrawal provisions of § 69.3(e)(6) and (9), a telephone company or group of affiliated telephone companies that participates in one or more Association tariffs during the current tariff year and that elects to file price cap tariffs or optional incentive regulation tariffs effective July 1 of the following tariff year, shall notify the Association with at least 6 months' notice that it is withdrawing from all Association tariffs, subject to the terms of this Rule, to participate in price cap regulation or optional incentive regulation.

* * * * *

(3) Notwithstanding the provisions of § 69.3(e)(3), (6), and (9), in the event a telephone company withdraws from all Association tariffs for the purpose of filing price cap tariffs or optional incentive plan tariffs, such company shall exclude from such withdrawal all "average schedule" affiliates and all affiliates so excluded shall be specified in the withdrawal. However, such company may include one or more "average schedule" affiliates in price cap regulation or optional incentive plan regulation provided that each price cap or optional incentive plan affiliate relinquishes "average schedule" status and withdraws from all Association tariffs and any tariff filed pursuant to 61.39(b)(2) of this chapter. See generally §§ 69.605(c), 61.39(b) of this chapter; MTS and WATS Market Structure: Average Schedule Companies, Report and Order, 103 FCC 2D 1026-1027 (1986).

* * * * *